

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05  
CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00  
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FM AMEMBASSY ANKARA  
TO SECSTATE WASHDC 5705  
INFO USMISSION OECD PARIS  
AMCONSUL ISTANBUL  
AMCONSUL IZMIR  
AMCONSUL ADANA

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E.O. 11652: GDS  
TAGS: EFIN, EINV, EALR, PFOR, TU  
SUBJECT: GROWING DEPENDENCE OF TURKISH ECONOMY ON U.S. PRIVATE  
FINANCING

1. SUMMARY. DURING THE NEXT THREE MONTHS THE DEMIREL  
GOVERNMENT WILL NEED TO COMPLETE THREE MAJOR GOVERNMENT PRO-  
GRAMS--1977 BUDGET, 1977 ANNUAL PROGRAM AND 1977 TRADE  
REGIME--WHICH WILL SET COUNTRY'S ECONOMIC POLICY FOR COMING  
YEAR. IN ADDITION, GOVERNMENT PLANNING FOR FOURTH FIVE  
YEAR PLAN (1978-82), WHICH MUST BE PRESENTED TO PARLIAMENT  
DURING 1977, HAS BEGUN. WHILE STATE OF ECONOMY WILL ALMOST  
CERTAINLY BE A MAJOR THEME IN COMING CAMPAIGN  
LEADING TO OCTOBER 1977 ELECTIONS, DEBATE ON INDUSTRIALIZATION,  
INFLATION AND FINANCE WILL PROBABLY NOT FOCUS ON BASIC ISSUE  
OF GROWING EXTERNAL DEFICITS NEEDED TO MAINTAIN CURRENT INDUS-  
TRIALIZATION STRATEGY. YEAR-LONG ELECTION CAMPAIGN WILL  
MAKE IT DIFFICULT FOR DEMIREL GOVERNMENT TO CUT BACK ON  
EITHER CONSUMPTION OR INVESTMENT EXPENDITURES. NEED FOR  
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DOMESTIC LIQUIDITY TO SATISFY ASPIRATIONS OF ELECTORATE  
WILL FUEL INFLATION AND INCREASE EXTERNAL DEFICIT. U.S. BANKING  
COMMUNITY IS CONCERNED ABOUT ITS GROWING EXPOSURE IN FINAN-  
CING THIS DEFICIT. GIVEN FOREIGN EXCHANGE REQUIREMENTS OF  
TURKISH ECONOMY FOR BOTH MILITARY AND CIVILIAN EX-  
PENDITURES, THE RELATIONSHIP BETWEEN U.S. BANKING COMMU-

NITY AND GOT WLL HAVE INCREASING IMPACT ON U.S.-TURKISH POLITICAL AND SECURITY RELATIONSHIPS. END SUMMARY.

2. ALL POLITICAL PARTIES IN TURKEY ARE DETERMINED TO FOLLOW EXPANSIONARY FISCAL AND MONETARY POLICIES THAT WILL CONTRIBUTE TO THE INDUSTRIALIZATION PROGRAM AND 7-8 PERCENT REAL ANNUAL GROWTH IN GNP THAT HAS BEEN ATTAINED DURING THE PAST FEW YEARS. RELATIVELY STAGNANT GROWTH IN EXPORTS AND INVISIBLES OVER THE PAST THREE YEARS, HOWEVER, HAS MEANT THAT THE GREATLY INCREASED IMPORT BILL NEEDED TO MAINTAIN THE INDUSTRIALIZATION DRIVE HAS CAUSED A SERIOUS DEFICIT IN THE COUNTRY'S INTERNATIONAL PAYMENTS ACCOUNT. TURKEY SUFFERED FROM A BALANCE OF TRADE DEFICIT OF \$3.3 BILLION, A CURRENT ACCOUNT DEFICIT OF \$1.8 BILLION, AND A BASIC DEFICIT OF \$1.3 BILLION IN 1975. IN SPITE OF EXPORT GROWTH OF OVER 40 PERCENT, IT IS LIKELY THAT TURKEY WILL HAVE A TRADE DEFICIT OF \$3 BILLION IN 1976. PRELIMINARY ESTIMATES AVAILABLE FOR THE 1977 ANNUAL PROGRAM AND 1977 TRADE REGIME INDICATE THAT THE GOT IS PROJECTING A \$2.5-3 BILLION TRADE DEFICIT FOR 1977. SINCE IT IS CONSIDERED UNLIKELY THAT INVISIBLES AND LONG-TERM CAPITAL INFLOWS WILL RISE MUCH ABOVE THIS YEAR'S LEVEL, GOT APPEARS TO BE PLANNING A REPETITION OF PAST TWO YEARS IN REGARD TO FNANCING A BASIC DEFICIT OF OVER \$1 BILLION.

3. GOT IS FINANCING ITS 1976 BASIC DEFICIT IN MUCH SAME WAY AS IT DID IN 1975, THROUGH IMF BORROWINGS, DRAW-DOWN OF RESERVES, AND SHORT-TERM CAPITAL INFLOWS. THE GOT BORROWED \$300 MILLION FROM THE IMF IN 1975 AND \$149 MILLION THUS FAR IN 1976. OFFICIAL GOLD AND FOREIGN EXCHANGE RESERVES WERE \$900 MILLION ON NOVEMBER 12, 1976, AS OPPOSED TO \$1.6 BILLION ON JANUARY 1, 1976.

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SHORT-TERM CAPITAL INFLOWS HAVE BEEN OVER \$1.5 BILLION NET SINCE MAY 1975, OF WHICH \$600 MILLION CAME IN 1976. MOST SHORT-TERM CAPITAL INFLOWS HAVE COME IN UNDER THE "CONVERTIBLE LIRA DEPOSIT FACILITY", HAVE MATURITIES UNDER 18 MONTHS, ARE USED PRIMARILY TO FINANCE IMPORTS FOR PRIVATE SECTOR, AND HAVE EXCHANGE RISK ON PRINCIPLE AND INTEREST GUARANTEED BY CENTRAL BANK. LEGALLY, INTEREST RATE ON DEPOSITS CANNOT EXCEED 1.75 PERCENT OVER LONDON INTERBANK RATE, BUT AS SYSTEM HAS EVOLVED, NEED FOR FINANCING HAS COVERTLY RAISED SPREAD FOR AT LEAST 1/3 OF INFLOWS TO 6-8 PERCENT. REAL COST OF DEPOSITS TO TURKISH ECONOMY IS VIRTUALLY IMPOSSIBLE TO FIGURE, BUT SOME SOURCES ESTIMATE THAT \$250 MILLION ANNUAL DEBT-SERVICE ON GOT DEBT MIGHT BE DOUBLED IF DEBT-SERVICE ON SHORT-TERM INFLOWS COULD BE DETERMINED.

4. WHILE PROSPECTS FOR TURKISH BALANCE OF PAYMENTS OVER NEXT YEAR ARE HARDLY BRIGHT, PRELIMINARY PROJECTIONS FOR FOURTH FIVE YEAR PLAN (1978-1982) INDICATE THAT GOT PLANS TO CONTINUE MASSIVE EXTERNAL BORROWINGS FOR ITS INVESTMENT PROGRAMS. IN LONGER-TERM,

EVEN LEAVING ASIDE GRANDIOSE PROJECTS PLANNED BY DEPUTY PRIME MINISTER ERBAKAN, IT APPEARS THAT GOT PROJECTIONS FOR THE PLAN PERIOD ARE PREDICTED ON IMPORTS OF \$37-40 BILLION, EXPORTS OF \$16-18 BILLION, NET INVISIBLES OF \$8-10 BILLION AND A FIVE YEAR CUMULATIVE CURRENT ACCOUNT DEFICIT OF \$12-15 BILLION. SUCH A DEFICIT WILL BE DIFFICULT TO HANDLE WITH A 1975 AND 1976 AVERAGE OF \$500 MILLION PER YESSR IN CAPITAL ACCOUNT INFLOWS. WHILE RELIANCE ON RESERVE DRAW-DOWNS, IMF FUNDING, AND SHORT-TERM BORROWINGS HAS GOTTEN TURKEY THROUGH 1975 AND 1976, THIS IS HARDLY A SOLUTION FOR LONGER-TERM.

5. TURKISH DEBT PAYABLE IN FOREIGN EXCHANGE HAS GROWN RAPIDLY IN PAST THREE YEARS. EVEN MORE SERIOUS, HOWEVER, HAS BEEN FACT THAT WITH VIRTUAL ENDING OF CONCESSIONAL ASSISTANCE AND MORE DEPENDENCE ON PRIVATE SOURCES AND NON-CONCESSIONAL WORLD BANK FINANCING, THE NATURE OF DEBT AND TERMS OF REPAYMENT HAVE CHANGED DRAMATICALLY. TURKISH DEBT PAYABLE IN FOREIGN EXCHANGE AT END OF 1973, FOR EXAMPLE, WAS \$1.8 BILLION AS OPPOSED TO DEBT, EXCLUSIVE OF SHORT-TERM

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AND SYNDICATED MEDIUM-TERM BORROWING, OF \$3 BILLION AT END OF 1975. DURING THE PAST 18 MONTHS, TURKEY HAS BORROWED SHORT-TERM \$1.5 BILLION NET ON THE EUROCURRENCY MARKET IN ADDITION TO \$350 MILLION IN SYNDICATED MEDIUM-TERM LOANS. NEED TO ROLL OVER SHORT-TERM DEBT WHILE ATTEMPTING TO ACQUIRE NEW EXTERNAL FUNDS TO CONTINUE INVESTMENT DRIVE AND PROVIDE NECESSARY RESOURCES FOR MILITARY ARE TAXING TUJKISH FINANCIAL AUTHORITIES SEVERELY.

6. COMMENT: 1973 OIL PRICE INCREASE AND SUBSEQUENT EUROPEAN RECESSION STRUCK TURKEY AT PARTICULARLY DIS-ADVANTAGEOUS TIME. TURKEY'S EXTERNAL BALANCE HAD BEEN IMPROVING AND ITS PER CAPITA INCOME RISING. US AND OECD HAD VIRTUALLY CEASED THEIR CONCESSIONAL DEVELOPMENT FINANCING AND US MILITARY ASSISTANCE WAS SHIFTING IN LARGE PART FROM GRANTS TO CREDITS. TURKEY APPEARED READY TO DEPEND ON NON-CONCESSIONAL CAPITAL INFLOWS TO CONTINUE ITS DEVELOPMENT DRIVE. BUT THE UNFAVORABLE EXTERNAL ECONOMIC ENVIRONMENT CAUSED BY THE OIL PRICE RISE HAS MADE IT INCREASINGLY DIFFICULT FOR TURKEY TO BRIDGE THE TRANSITION FROM MAJOR AID RECIPIENT AND SIMULTANEOUSLY TO FUND ITS AMBITIOUS INDUSTRIALIZATION DRIVE AND MAINTAIN A POWERFUL MILITARY DETERRENT. IN ADDITION, GOT POLICY OF INTENSIVE, IMPORT-SUBSTITUTION INDUSTRIALIZATION HAS LED TO HIGH-COST INDUSTRY DEPENDENT ON A PROFITABLE, PROTECTED MARKET WITH LITTLE INCENTIVE TO EXPORT AND REQUIRING INCREASING IMPORTS OF INVESTMENT GOODS AND RAW MATERIALS. WEAK GOVERNMENTS OF 1970S HAVE BEEN UNABLE OR UNWILLING TO ASK FOR SACRIFICES AND CUTS IN GROWING PUBLIC AND PRIVATE CONSUMPTION EXPENDITURES THAT COULD HAVE FINANCED MAMMOTH INVESTMENT EXPENDITURES NEEDED TO FUEL DEVELOPMENT DRIVE WITHOUT EXTERNAL DEFICITS AND 20-25 PERCENT ANNUAL INFLATION OF LAST THREE YEARS.

7. HEAVY INVOLVEMENT OF US BANKS IN RECENT TURKISH  
FINANCING DIFFICULTIES IS INTRODUCING A NEW ELEMENT INTO  
U.S.-TURKISH RELATIONS. WHILE MAGNITUDE OF U.S. BANING EX-  
POSURE IN TURKEY IS DIFFICULT TO DETERMINE, WE ESTIMATE, BASED  
ON INFORMED BANK SOURCES, THAT EXPOSURE FOR ONLY SEVEN  
MAJOR U.S. BANKS CITICORP, MORGAN,  
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BANKERS TRUST, WELLS FARGO, CHEMICAL, IRVING TRUST, AND  
CHASE MANHATTAN IS CURRENTLY APPROXIMATELY \$1 BILLION. U.S.-  
TURKISH ECONOMIC RELATIONS SINCE WORLD WAR II HAVE BEEN MUCH  
LESS IMPORTANT THAN OUR POLITICAL AND SECURITY RELATIONSHIPS.  
NOW, HOWEVER, THE GROWING U.S. PRIVATE FINANCIAL EXPOSURE  
IN RELATIVELY VOLATILE SHORT-TERM LENDING COULD HAVE A REAL  
INFLUENCE ON TURKEY-U.S. BILATERAL POLITICAL RELATIONSHIP. TURKISH  
DEPENDENCE ON U.S. INTERNATIONAL BANKING  
CONFIDENCE IS NOT WIDELY UNDERSTOOD IN POLITICAL CIRCLES  
HERE. A LOSS IN THAT CONFIDENCE COULD LEAD TO A RAPID WITH-  
DRAWAL OF CAPITAL THAT WOULD MAKE IT VERY DIFFICULT FOR  
GOT TO MAINTAIN BOTH ITS HEAVY INVESTMENT DRIVE AND STRONG  
MILITARY COMMITMENT TO NATO. ALMOST CERTAIN TURKISH PER-  
CEPTION THAT USG SHOULD BE HELD AT LEAST PARTIALLY RESPONSIBLE  
FOR THIS STATE OF AFFAIRS COULD HAVE SERIOUS IMPACT ON  
BOTH OUR POLITICAL AND SECURITY RELATIONSHIPS.  
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## Message Attributes

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